Corrected Transcript

02-Feb-2022

Johnson Controls International Plc (JCI)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Johnson Controls' First Quarter 2022 Earnings Call. Your lines have been placed on a listen-only until the question-and-answer session. [Operator Instructions] This conference is being recorded. If you have any objections, you may disconnect at this time.

I will now turn the call over to Antonella Franzen, Vice President and Chief Investor Relations and Communications Officer.

Antonella Franzen

Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc

Good morning and thank you for joining our conference call to discuss Johnson Controls' First Quarter Fiscal 2022 results. The press release and all related tables issued earlier this morning as well as the conference call slide presentation can be found on the Investor Relations portion of our website at johnsoncontrols.com. Joining me on the call today are Johnson Controls' Chairman and Chief Executive Officer, George Oliver; and our Chief Financial Officer, Olivier Leonetti.

Before we begin, I'd like to remind you that during the course of today's call, we will be providing certain forward-looking information. We ask that you review today's press release and read through the forward-looking cautionary informational statements that we've included there. In addition, we will use certain non-GAAP measures in our discussions and we ask that you read through the sections of our press release that address the use of these items.

In discussing our results during the call, references to adjusted earnings per share, EBITA and EBIT exclude restructuring as well as other special items. These metrics, together with organic sales and free cash flow are non-GAAP measures and are reconciled in the schedules attached to our press release and in the appendix to the presentation posted on our website. Additionally, all comparisons to the prior year are on a continuing ops basis.

Now let me turn the call over to George.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Thanks, Antonella, and good morning everyone. Thank you for joining us on the call today.

Let's get started on slide 3. We are off to a strong start in fiscal 2022 with solid Q1 results as our teams across the world continue to demonstrate best-in-class execution, delivering both strong financial performance for the enterprise and smart innovative solutions our customers demand to ensure safe, healthy and sustainable spaces. Our Service activity in the quarter accelerated from both an orders and revenue perspective and we are making great strides across all of our vectors of growth, decarbonization, healthy buildings and smart buildings. I'm incredibly proud of how the team is operating in what still remains an incredibly challenging environment as we continue to face headwinds from supply chain and labor constraints and various dislocations caused by the latest variant of COVID-19. As the recovery in our end-markets expands, I've been continuously encouraged by the underlying demand trends we are witnessing as evidenced by high single-digit order and revenue growth this quarter and the $10.5 billion backlog we have built which increased 10% on a year-over-year basis.

What has been equally as encouraging is the drivers of this demand have been the retrofit and replacement of equipment and service offerings required to achieve higher indoor air quality, cost reduction and energy efficiency goals which perfectly aligns with our portfolio of end-to-end digital solutions and services. We continue to advance our initiatives to accelerate growth and transform our Service business. Q1 was another quarter of solid revenue and order growth and we continue to drive our attachment rate higher with a multifaceted approach, including a number of digitally enabled solutions. Additionally, there are significant actions underway across the organization to optimize the efficiency of our cost structure and we remain on track to deliver $230 million in productivity savings this year.

We had another quarter of strong free cash flow performance. As Olivier will share with you later, this has allowed us to continue to fund organic reinvestment in our business as well as share repurchase and M&A activity, all three of which remain top priorities. Over the next several slides, I will update you on some of the strategic growth vectors we continue to highlight and all of these are supported by the global megatrends that will drive demand within the building sector for the next decade-plus. As we have said in the past, we truly believe we are among the best-in-class when it comes to the ability to deliver fully integrated solutions designed to address the challenges associated with these trends. Based on our performance in Q1 and our expectations for the remainder of the year, we are reaffirming our EPS guidance for the year.

Please turn to slide 4. During the quarter, we were honored to be recognized for our leadership in sustainability and ESG as well as our innovations in smart building platforms. We received our eighth consecutive ranking in the Corporate Knights' 100 Most Sustainable Corporations in the World. We were recognized by Sustainalytics for managing material ESG issues and we are one of 45 companies globally to receive His Royal Highness, the Prince Wales' inaugural Terra Carta Seal.

In terms of smart buildings, I was humbled to receive, on behalf of the company, the IoT Company's CEO of the Year Award from IoT Breakthrough. This award is a reflection of the work of our entire digital and OpenBlue teams, engineering, development, sales, service and marketing. Lastly, we were also recognized by Verdantix for having the most prominent IoT platform for smart buildings in 2022, having achieved market-leading scores in several key categories.

Please turn to slide 5. Our Service business continues to perform well. We are seeing good traction on our initiatives to accelerate growth and increase recurring revenues. We are also seeing encouraging trends in the adoption of our OpenBlue digital service offerings. Overall, Service revenues in the quarter were up 5% with broad-based growth across all regions. Orders were up 7%, led by low double-digit growth in North America with strength across our Applied Commercial HVAC and Fire & Security platforms. We expect a 400 to 500-basis point improvement in our attach rate for the full-year and ended Q1 at approximately 41%.

Turning to slide 6, it goes without saying that sustainability is at the heart of everything we do. There are tremendous efforts underway in all parts of the world to decarbonize and it has become very clear that buildings play a pivotal role in these efforts. We were pleased to see the recent announcement from the Biden administration forming a new National Building Performance Standards Coalition consisting of more than 30 state and local governments across the US, incentivizing the development of healthier, lower carbon-emitting buildings. Building performance standards are among the core policy initiatives we have flagged as primary demand drivers for decarbonization and achieving net zero. This major announcement by the White House is the latest in a number of regulatory actions taken by the local and national governments globally in support of decarbonizing economies and more specifically in support of accelerating progress towards net zero buildings. These standards will mandate stringent carbon reduction requirements for new and existing buildings in the US, including financial penalties for non-compliance. The official adoption of these standards would represent an important step towards the formation of the $240 billion decarbonization industry we expect through 2035.

Moving to slide 7, we recently launched our latest offering under the OpenBlue Healthy Buildings portfolio, Indoor Air Quality-as-a-Service. This is the industry's first dedicated as-a-service model for delivering indoor air quality. This offering allows us to combine our traditional holistic approach to delivering healthy indoor environments with innovative financing models that eliminate the need for our customers to commit capital upfront, lowering the risk and time to implement. This offering provides a turnkey solution that delivers clean air while simultaneously optimizing the energy efficiency of a building, all while leveraging a subscription-based model. Solutions like these enabled by OpenBlue are truly differentiating factors when it comes to our customers' decision-making process. Importantly, we continue to expand our partner ecosystem not only to supplement our solution portfolio but also to advance our research and development. This quarter, we announced an important partnership with the Asthma and Allergy Foundation of America to advance our advocacy of indoor air quality.

We also kicked off a collaboration with Well Living Lab in the Mayo Clinic to study the cognitive and productivity benefits associated with enhancements to ventilation and filtration which will leverage the partnership established with Biogen last quarter.

Next on slide 8, we are very excited to welcome FogHorn to the Johnson Controls team. FogHorn is recognized as the industry's leading developer of edge AI software for industrial and commercial IoT solutions with the most advanced technology. Their edge intelligence, combined with cloud-based model building enables secure real-time machine learning to take place at the device level which means easier access to actionable insights and increased flexibility for our customers. FogHorn's software will be integrated throughout the entire OpenBlue platform embedded within our OpenBlue Bridge data exchange which will allow us an even better value proposition when it comes to applying intelligence at the edge device level faster, more secure and at a lower cost relative to cloud-based applications. We view edge intelligence as a critical technology for the future of smart autonomous buildings and for Johnson Controls. FogHorn gives us, in our OpenBlue platform, an immediate competitive advantage in edge AI with a software platform that is widely recognized as best-in-class. It avoids the time and cost to build out these capabilities organically.

Please turn to slide 9. Among the notable wins for these themes in Q1, we have a few examples across regions all centered around sustainability. In North America, we are partnering with the University of Windsor on their 2030 carbon reduction plan as well as their 2050 carbon neutrality objectives. We will be installing a uniquely configured chiller on our AI-enabled OpenBlue connected chiller platform which will ensure optimal chiller performance and enable digital service.

We are excited to be partnering with Aldar Properties, a prominent developer in the UAE as they begin a digital transformation to achieve their sustainability commitments. We were awarded an energy performance contract to improve the energy efficiency across Aldar's network of schools in Abu Dhabi. In addition to replacing the HVAC equipment and other energy-consuming assets, we will also be deploying our OpenBlue Net Zero Buildings portfolio of digital solutions.

In China, we were selected to upgrade an existing customer's Metasys building automation system and controls system and integrate OpenBlue on-prem to leverage key AI capabilities that will optimize the chiller performance to reduce energy consumption. This includes a long-term service agreement leveraging our digital capabilities.

These are great examples of the power and breadth of our portfolio where we deliver tailored, sustainable outcomes for our customers while expanding our installed base and driving attractive recurring Service growth.

To wrap up my prepared remarks, I remain extremely excited about the continued advancements we have made relative to our key growth vectors and I couldn't be more pleased with the way our teams are executing in such a difficult environment. We remain laser-focused on our strategic commitments into delivering the outcomes our customers need on the path to a healthy and more sustainable future.

With that, I'm going to turn the call over to Olivier to walk you through the financial details in the quarter and update you on our outlook for Q2 and for the full-year. Olivier?

Olivier Leonetti

Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

Thanks, George, and good morning, everyone. Let me start with the summary on slide 10. Sales in the quarter were up 8% organically above our original guidance for mid-single digit growth and led by strong outperformance across the global product portfolio. Our longer cycle field businesses also performed well, up 6% with solid growth in both Service and Install. Price contributed to about 4.5 points of our total organic growth, about 1 point above our expectation.

Segment EBITA increased 13% versus the prior year, with margins expanding 30 basis points to 12.3%, including a 100 basis points margin headwinds from price/cost and significant operational inefficiencies related to ongoing supply chain disruptions and worsening labor constraints. This was more than offset by strong leverage on higher volumes and the incremental benefit of our COGS and SG&A actions.

Just to comment on the impact of the operational efficiencies. As I mentioned, we were able to yield 4.5 points of price. Beyond raw materials, inflation on most other items, freight, logistics, labor and components, increased further and absorbed the benefit of the increased pricing. Additionally, ongoing supply chain disruptions and labor shortages impacted our field operations where we were dealing with not only our own disruptions, but those of our customers as well. Versus our guidance for Q1, this was an incremental headwind of 40 basis points.

Overall, our underlying margin performance in the quarter was very strong. EPS of $0.54 was at the high end of our guidance range and increased 26% year-over-year benefiting from higher profitability as well as lower share count. Free cash flow in the quarter was just over $250 million, primarily the result of a continued focus on working capital management.

Turning to our EPS bridge on slide 11, overall operations contributed $0.10 versus the prior year, including a $0.06 benefit from our COGS and SG&A productivity programs. Underlying segment earnings were a net $0.04 tailwind year-over-year, which we view as a significant achievement in the current environment. Excluding the headwinds from price/cost, underlying incremental in Q1 were approximately 40%.

Please turn to slide 12. Orders for our field businesses increased 8% in aggregate with fairly balanced growth between Service and Install activity. Growth in Service orders is being led by a double-digit increase in our short-term transactional business, but also a mid-single digit increase in our contractual recurring revenue base. Install demand continues to rebound, primarily driven by a low-double digit increase in retrofit activity globally, including mid-teens growth in North America. Backlog grew 10% to nearly $10.5 billion with Service backlog up 4% and Install backlog up 11%. The year-over-year increase was led by higher retrofit activity in North America and EMEA/LA and new construction activity in APAC.

Let's discuss our segment results in more details on slide 13. My commentary will also refer to the segment end-market performance included on slide 14. Sales in North America were up 5% organically, led by 7% growth in Service. Install sales increased 4%. Similar to last quarter, supply chain disruptions and material availability negatively impacted revenue conversion in our North America business.

Commercial Applied HVAC revenue grew low-double digits, including low-double digit growth both in equipment and service. Fire & Security increased mid-single digits in the quarter. Performance Infrastructure declined high-single digits given the tough prior-year comparison of plus 20%. Looking at the two-year stack for Performance Infrastructure, we are up double digit with an exciting pipeline of opportunities ahead.

Segment margin decreased 90 basis points year-over-year to 11.6%, including an 80 basis point impact from lower absorptions given the operational inefficiencies related to material and labor availability. We are also intentionally maintaining a higher level of sales investments given our order activity is up more than double of revenue growth in the quarter. The combination of these factors will remain a headwind in the second quarter and significantly improve from there.

Orders in North America were up 11% versus the prior year with high-teens growth in Commercial Applied, including a significant increase in HVAC equipment orders driven by very strong demand in the data center and healthcare verticals. Fire & Security orders were up low-teens with strength in both Install and Service. Backlog of $6.5 billion increased 12% year-over-year.

EMEA/LA revenue increased 3%, led by continued strength in the Fire & Security business which grew at mid-single digit rates in Q1. This was primarily driven by a sharp rebound in our retail platform and modest growth in our core offerings due to the material availability constraints. Industrial Refrigeration grew low-single digits, while Commercial HVAC & Controls was relatively flat.

Segment EBITA margin expanded 50 basis points, underlying margin performance improved as positive price/cost and the benefit of SG&A/COGS savings more than offset the modest mix headwind. Orders in EMEA/LA were up 3% in the quarter with high-single digit growth in Fire & Security and low-single digit growth in Commercial HVAC. Backlog ended the quarter at $2.2 billion, up 12%.

Sales in Asia Pacific increased 12% organically led by mid-teens growth in Commercial HVAC & Controls. China continued to outperform with revenue up nearly 30%. EBITA margin declined 260 basis points year-over-year to 10.1%, driven by headwinds from price/cost as well as unfavorable business and geographic mix. We do believe Q1 represents peak margin pressure for APAC and we would expect margins to significantly improve as the year progresses. APAC orders were up 5% with continued strength in Commercial HVAC, driven by a strong rebound within the industrial vertical in China as well as the benefit of a large infrastructure development project currently underway in Japan which will include a significant deployment of OpenBlue and digitally enabled services. Backlog of $1.8 billion was up 2% year-over-year.

Global Products sales increased 14% organically in the quarter with broad-based strength across the portfolio led by mid-teens growth across our HVAC equipment platforms. Global Residential HVAC sales were up 11% overall in Q1. North America Resi HVAC grew 17% in the quarter, benefiting from both higher growth in our part business and strong price realization. We have been very successful in ramping production of our new facility in Mexico. So far we are at about 30% capacity and still on track for full run rate later in the year. In Rest of the World, Resi HVAC grew high single-digits, led by strong double-digit growth in Europe as the adoption of our new Hitachi air-to-water residential heat pump launched last quarter continues to improve. In APAC, Resi HVAC was relatively flat as a result of softer industry demand in Japan related to more mild weather, offset by strong growth in Taiwan and India. Although not reflected in our revenue growth, sales in our in Hisense JV were up low-teens year-over-year in Q1 as we continue to expand our distribution footprint in China.

Commercial HVAC product sales were up high-teens in aggregate with similar levels of growth in both Applied and Light Commercial. Strength in Applied was driven by increased demand within the data center end-markets for our air-cooled chillers and evaporative cooling solutions as well as our Industrial Refrigeration platforms. Strength in Light Commercial was driven by strong performance at Hitachi which was up over 50% as well as mid-teens growth in North America unitary equipment and high single-digit growth in VRF. Fire & Security products grew low double-digits in aggregate, led by a continued recovery in our commercial fire suppression business and mid-teens growth in access control and video solutions. EBITA margin expanded 240 basis points year-over-year to 14.5% as volume leverage, higher equity income and the benefit of productivity actions more than offset headwinds from price/cost.

Turning to slide 15, corporate expense was up slightly year-over-year year to $70 million. For modeling purposes, we have included some of our below-the-line items for FY 2022.

Turning to our balance sheet and cash flow on slide 16, our balance sheet remains in great shape with no major changes to highlight in the quarter. We ended up Q1 with $1.2 billion in available cash and net debt at 1.9 times, one tick higher versus year-end but still below our target range of 2 to 2.5 times.

On cash, we generated a little over $250 million in free cash flow in the quarter, down year-over-year due to the absence of prior-year tax credits and other COVID-related benefits as well as nearly a 50% increase in CapEx spend year-over-year. We had another quarter of strong trade working capital management, down 140 basis points as a percentage of sales. With a continued focus on working capital, we remain confident that we will sustain 100% conversion over the next several years. From a capital allocation standpoint, we are executing our game plan. We repurchased approximately 7 million shares for just over $500 million, deploying roughly $100 million towards bolt-on acquisitions and increased our quarterly cash dividend payment by 26%.

Before we get into guidance, I want to comment on two reporting changes that occurred in the first quarter. First, effective at the start of the fiscal year, our Marine business which was previously split across Asia Pacific and Global Products and EMEA/LA is now managed and reported under our EMEA/LA segment. Historical segment results have been recast for comparability.

Second, as part of the ongoing transformation of our Service business, beginning with first quarter results we are aligning the way we report revenue associated with certain types of retrofit activity we performed in EMEA/LA and APAC field businesses as they have evolved to be more aligned with similar offering in North America. From a management perspective, this provides better visibility to our initiatives aimed at accelerating our higher-margin recurring revenue base. The changes are being made on a prospective basis. To help with comparisons going forward, we have included recasted segment results and a table with pro forma Service revenue for FY 2021 in the appendix.

Now, let me get into guidance on slide 17. As George mentioned, we are reaffirming our full-year adjusted EPS guidance range of $3.22 to $3.32 which represents year-over-year growth of 22% to 25%. Given the continued inflationary environment, we are increasing our organic revenue growth assumptions to a range of 8% to 10%, mainly driven by our increased price expectation. An additional point of price on the top line will create an incremental margin headwind of approximately 20 basis points. We continue to expect price/cost will remain positive on an EPS basis. However, the inflated level of pricing will bring our full-year price/cost margin headwind to approximately 60 basis points. Therefore, we now expect 50 to 60 basis points of segment EBITA margin expansion for the year. There was no change to underlying margin expansion of 110 to 120 basis points.

Let me specifically point out that there was no change to our expectation for segment EBITA dollars. Additionally, the strengthening US dollar has created an EPS headwind of $0.03 since we first provided guidance back in November and we are absorbing this incremental headwind with our reaffirmed adjusted EPS guidance range.

Turning to the second quarter, we expect continued strong performance with high single-digits organic revenue growth, improved segment EBITA margin expansion and adjusted EPS of $0.62 to $0.64 which represents a year-over-year increase of 19% to 23%.

Let me give back the call to George for some additional comments.

George R. Oliver

Chairman & Chief Executive Officer, Johnson Controls International Plc

Yeah. Before we move on to the Q&A portion of the call, I wanted to announce a quick update to my leadership team. This will be Antonella's final earnings call and she will be pursuing a new role outside of Johnson Controls.

Antonella has been one of my constants really since I first joined Tyco back in 2006. She has been an invaluable resource to me personally and I'm sure she has been, to many of you, for more than a decade. She has been a fantastic leader, a trusted adviser and a friend. Antonella, I can't thank you enough for all that you have done for me, for the Johnson Controls team and for the company. I couldn't be more happy for you. I know I speak for all of us when I say we wish you all the best and we look forward to hearing more about your success in your new role.

With that operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Andy Kaplowitz with Citigroup. Your line is open.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Good morning, guys.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc
A

Good morning, Andy.

Antonella Franzen
Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc
A

Good morning.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Antonella, good luck and sorry to see you go. So it looks like there seems to be more supply chain-related pressure in the field, particularly in North America versus your Global Products business which is performing well. So could you talk about what you're seeing in the field? And then it seems like you're assuming incremental margin actually get slightly better in fiscal Q2 versus Q1. Is that a reflection that field conditions are at least not getting worse in Q2 and maybe getting a little better?

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc
A

Andy, thank you for your question. So you're right. The environment is still challenging and this challenge is impacting availability of parts, availability of labor and obviously we are facing a high level of inflation. And the impact on our field business is in two aspects: One, first of all, our operation is impacted but also the one of our customers. And as a result, we mentioned that in our prepared remark, we had price/cost negative about $15 million in Q1 and a headwind also due to the disruption of our field business of about 18 million. So the sum of the two is a margin headwind of about 100 basis points.

Now, something I want to say is that despite this environment, we have been able to deliver the profit dollar we had committed to you. And actually, from an EPS standpoint, we are at the top end of our range. A few reasons for that: One, pricing. As we mentioned in our prepared remark, we have included 4.5 points of price in Q1. Second, we are facing strong demand and the value proposition of Johnson Controls really resonating with our customers. Third, we have also been very disciplined regarding the management of our P&L from a COGS and SG&A standpoint, as a result you saw the bottom line we have mentioned.

So we believe that the headwinds are going to start to be better as we go through the year. We are going to have headwind in Q2 about 80 basis points and for the rest of the year as the revenue orders which were booked at a much higher margin and we have strong visibility of this, in the second-half we will expect to have tailwind regarding the margin performance of our business.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Okay. That's very helpful. And then George I think you raised your attachment rate expectations slightly to 400 to 500 basis points. I think you were talking about 300 to 400 basis points. It isn't a huge change but is the change a reflection of JCI continuing to penetrate the market faster through OpenBlue and your digital offerings? And then, does the higher rate of penetration mean you might be able to outperform your markets by more than that 200 to 300 basis points that you've talked about?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah, Andy. What I would say is Service is a significant area of focus and our key growth accelerator. In addition to the traditional Service business, digital now and the new OpenBlue offerings, that has really helped us to increase our attach rates. And then not only with that attachment be able to now launch a lot of new digital offerings that then enables us to be able to get more revenue per customer and ultimately deliver different outcomes.

And so, as a result, you saw our Service orders were up 7% in the first quarter. That was led by double-digit growth in North America, although we did see growth across all regions and domains. And we're also seeing our L&M business come back with more access to our customers. So when we look on a go-forward basis relative to your question on attach, we do expect our Service orders to continue to grow. And so when you look at the attach rate, it is built on the digitization of our services.

We're planning to launch 20 new Service products and offerings in 2022 and this is where we're taking our OpenBlue capabilities and actually delivering an indoor air quality level or clean air delivery rate or sustainability solutions, the energy reduction solutions, all of the above, on top of what our attach and our core business would be. And so, we're very excited about the progress we've made, and more important now with the pipeline that we have on these new Service offerings that gives us the opportunity to not only attach more, but with that connect more, attach more and then ultimately deliver additional services on top of that connectivity.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Appreciate it, guys.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

Thank you, Andy.

Operator: Thank you. Our next question comes from Jeff Sprague with Vertical Research Partners. Your line is open.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Thanks. Good morning, everyone. Antonella, congrats. I look forward to hearing what it's all about very soon. I appreciate all the help over the years.

Two questions from me; first, just picking up on the last one. George, can you give us any indication yet of how revenue per user is changing? I mean, we're kind of early days on this OpenBlue journey, but I wonder if there is kind of a measurable and quantifiable change in revenue per user that you could share with us.

And secondly, kind of tied to the Service question, when you look at the strength now of these Install orders and the growth of the Install backlog, do you in fact see kind of higher-than-normal attachment and Service tail on that Install work than you did previously? Maybe a little bit of color there would be interesting. Appreciate it. Thanks.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah. So, let me start by just giving you the framework for Service and the work that we've been doing over the last 18 months and, more important, how that's playing out this year. We've got about a $6 billion Service business. About 60% is recurring today and, obviously, very proud of the progress we've made. And it is the focus of our growth vectors. And so when you look at the Install base that we have, historically, it's been underserved and much of that was served with mechanical services, Jeff.

And so, what we've been doing is, over the last really 18 months, is getting everything really going after that Install base to get it connected so that we can then attach, so we can take existing mechanical PSAs and/or new PSAs and attach with that connectivity. And then, with that connectivity, be able to now begin to deploy some of the new services; whether it be connected chiller services and focusing on uptime of the chiller or reduced energy of the chiller or indoor air quality solutions.

We've got an array of solutions that we've now launched that with OpenBlue gives us the opportunity to tailor into our air quality solutions for the verticals that we support. And so, all of that has been going on. When you look at the current, our projection is that we'll grow our Service business 200 or 300 basis points above the market. And specifically, to your point, it's all been about operationalizing Service.

So, we've got a huge Install base, get it connected, and then attach when we're going after either renewing our existing PSAs and/or generating new PSAs. We then get an attached connected PSA and then it's ultimately selling more. And we've already launched 12 digital offerings. We've got a pipeline of – it's probably $300 million or $400 million of opportunity that we have to go back into that install base and be able to bring these services to them.

And so when you ask about what is the connectivity, we're at a very low level today based on – we have our Security business, which 100% is attached. But when you look at the other businesses, we have a much lower percentage, when I say connected and with an attached PSA. And so, we're working through that to forecast what that's going to mean not only through the year, but throughout years and what we can achieve purely with what's connected that then has a PSA attached to it.

But that's fundamental, Jeff, to our ability to be able to improve the way that we're measuring today the 400 to 500 basis points of improvement and then our ability to be able to then generate more revenue per customer because of the new solutions that are being now offered to where we have a connected PSA.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Great. Thank you.

Operator: Our next question comes from Scott Davis with Melius Research. Your line is open.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Hi. Good morning, George, Olivier and congrats...

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Good morning, Scott.

Antonella Franzen
Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc

A

Thank you.

Scott Reed Davis
Analyst, Melius Research LLC

Q

...also, appreciate the years of help and support. Anyways, I'm going to jump on the bandwagon here because I'm kind of fascinated with this FogHorn thing, but I don't understand it. What does it give you, George, that you didn't have before? And it feels like it's fairly high level. I mean, does the customer want something this advanced there?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah. So, let me frame this up for you, Scott. Number one, I couldn't be more excited about the capabilities that FogHorn, the software that they have brings to our OpenBlue platform. So, you need to think about this as the edge AI is going to become a critical technology to own when it comes to the future of smart autonomous buildings and, in many cases, across other industries. And there is more value to being created at the edge because it can be real-time, it can be more dependable analytics. It reduces the data being sent to the cloud which is obviously lower cost, more secure and it also improves the system resiliency. So it can operate; whether it be offline or without connectivity.

And so we see – let me give you a number here, we see edge AI penetration increasing six-fold through 2025. So when you think about an autonomous building there'll be more sensors, more AI deployed, more analytics. And by pushing that to the edge, ultimately with the capabilities that I said earlier is what ultimately makes it really attractive. And so for us, this was a buy versus build decision. We would have caused almost as much and probably would have had lengthened our development cycle another two years to establish the same level of the commercial success that FogHorn has today. And so you need to think of this as supplementing our product development for a product that we would have actually accelerated on our own spend. And then it catalyzes the creation of what we call our JCI AI Hub in Silicon Valley. That's where FogHorn is based. And it's allowing us to maintain the key engineering talent and now take what we were doing previously within JCI and put that together within the COE.

And if you look at their capabilities compared to what we've seen elsewhere across the industry, it is widely considered best-in-class and I would say it has the most advanced portfolio among their peers. So, think of this, Scott, as just an accelerator of our ability to deploy our AI solutions with OpenBlue, specifically to the verticals that we support that ultimately creates incredible value for our customers.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

An additional point, Scott, if I may, we had worked with the team for about a year and we are very pleased with the technology and also very pleased with the culture of FogHorn. So we believe it's a great fit.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Is FogHorn, do they have a broad customer base already George or are you buying the technology? Do they have an existing customer base that you can lever as well?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

They have an existing customer base where they were developing and developing vertical solutions. And so we've been working with them, as Olivier said, over the last year. And so as they were advancing with their capabilities, with our channel and the work that we're doing with OpenBlue just totally opened up the opportunity now to expand the market that they're serving.

Scott Reed Davis
Analyst, Melius Research LLC

Q

Sounds really cool. I'd love to see a demo some day. I'll pass it on. Thank you, guys. Good luck.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Thanks, Scott.

Antonella Franzen
Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc

A

Thanks.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

Take care.

Operator: Our next question comes from Julian Mitchell with Barclays. Your line is open.

Julian Mitchell
Analyst, Barclays Investment Bank

Q

Hi, good morning and I'll echo the thanks Franzen and wish you all the best.

Maybe just starting with the top line outlook. Just wanted to understand on Fire & Security, you had mid single-digit growth I think sort of all-in consolidated in the quarter organically. Maybe help us understand sort of within that how much less than the firm-wide average was the pricing tailwind? And also as you think about the balance of the year, do you see that mid single-digit Fire & Security growth rate accelerating?

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc
A

So let me speak about the guide in aggregate. If you look at – I'm going to talk about Q2 quickly and then talk about the full-year. For Q2, we expect revenue to be high single-digits. If I give it to you by the key operations as Johnson Controls, we expect Services to grow mid to high single-digits. Install, we expect install to grow at mid to high-single-digits, and we expect also our Global Products franchise to grow low [ph] double (00:45:15) digits, so continued strong performance. And we expect those trends to keep going for the full-year.

Fire & Security is doing very well but you see that the full portfolio is doing very well as well. We are very pleased with the Commercial HVAC, also Applied shares we have had. Our new product portfolio driving sustainability for our customers is resonating. So Fire & Security is doing well but the full portfolio is doing well as well, Julian.

Julian Mitchell
Analyst, Barclays Investment Bank
Q

Thank you. And then maybe just following up on the margin outlook, so Global Products had very good operating leverage in the first quarter, I think 30% or so year-on-year even with inflation and supply chain issues. So I guess looking at the balance of the year, wondered how you see that operating leverage playing out because you might get less of a mix tailwinds from Resi HVAC slowing down but maybe a help as inflation shrinks as a headwind as well. So how are you thinking about sort of Global Products' operating leverage for the year as a whole?

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc
A

So in aggregate as you can see from our guide, the – and what we said earlier Julian you see that price/cost is going to become more and more of a tailwind for the company. The reason for that is we are now recording revenue for orders which were priced at a much higher margin. And we see that playing also for Global Products, but also the entirety of the portfolio. So let me repeat some of the numbers. Headwind in Q1, 100 basis points; headwind in Q2 80 basis points, and for the second-half a tailwind due to price/cost of about 40 basis points and the net for the year of about 60 basis point headwind. And then important to mention is that the underlying margin is very strong and for the year would be at about 110 to 120 basis point increase.

Julian Mitchell
Analyst, Barclays Investment Bank
Q

Thanks very much. And there's no big mix headwind expected in Global Products as Resi slows down?

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc
A

Not really. I mean, if anything, we see mix starting to be more positive as we sell more services, more digital offering as George mentioned earlier.

Antonella Franzen
Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc
A

Yeah. And Julian, I would just add that if you're – in talking about Global Products specifically I mean the leverage in that business for the year is going to be around 30%.

Julian Mitchell
Analyst, Barclays Investment Bank
Q

That's great. Thank you.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc
A

Thank you.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc
A

Thanks, Julian.

Operator: Our next question comes from Nigel Coe with Wolfe Research. Your line is open.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Thanks. Good morning and Antonella congratulations. Good luck and we'll miss you. Thanks for all the help.

Antonella Franzen
Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc
A

Thank you.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Just on the last point, maybe Olivier, just to clarify. I'm assuming that the strong JV income would be helping with the products leverage. So that's probably a factor as well. But just curious on the North American retrofit comments I think you called out mid-teens order growth there and it sounds like that's strong. Would you clarify that as maybe just deferred retrofit activity or do you think there's something a bit more secular happening here?

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc
A

No. We are very pleased with our North America business. As we have mentioned in our prepared remark, the North America business has been highly impacted by disruptions for its operation but also the operations of our customers. But if you look at the underlying demand for North America, we have been growing orders in the quarter twice the revenue rate.

Clearly, the value proposition of Johnson Controls in North America is resonating. As we mentioned also we are investing in sales force to satisfy the demand. Now, we're not able to realize it yet but we will in the second part of the year. So we see the North America revenue to keep growing and we see also the margin rate to keep improving as we go through the year.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Okay.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc
A

Yeah. And just a comment on that, Nigel, when you look at...

Nigel Coe
Analyst, Wolfe Research LLC

Q

Yeah.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

...the backlog, the backlog is up 12% year-on-year. When you look at HVAC Controls, we're up about almost 20%. And so you would attribute it to all of the strategies, not only in the new product developments that are – the new product that's coming to market, the focus on decarbonization, on energy savings and now a significant lift on indoor air quality.

And when you look at indoor air quality, we're up nicely year-on-year after delivering $400 million in total. This would be across the globe last year. When we look at our orders here in Q2, we project those to be up about 45%. And so it's a combination of not only good core growth but now seeing the opportunity the way that we're executing on the growth vectors. And now when you look at even Services being up nicely in North America that is an output of the work that we've been doing strategically.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. Thanks, George. And then just a quick one on labor, we're hearing a lot of companies complaining about mass resignations and an inability to hire. I'm just wondering if in your Service business, if you've seen any kind of maybe amber flags or any red flags there? And any kind of capacity concerns that might gate Service growth due to labor constraints?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

So when I look at the supply chain disruptions overall and it is weighted towards North America, it is driven by labor broad-based. Now, what I would say inside our four walls, so within our manufacturing facilities and within our Install and Service business, we've been very effective in getting the ramp-up of labor that ultimately is required to continue to accelerate our growth. And so when you look at – I mean, the disruption that Olivier was talking about is really driven by our supply chain; chips and coils and other components that ultimately we've been adjusting to and making sure we're working around to mitigate the impact.

And so we've been very proactive, not only on the labor front ourselves but we've been also engaged with our suppliers. And so we've been very actively engaged with their labor situation to make sure that we're utilizing our labor services to ultimately get the labor they need to be able to keep our manufacturing facilities operating and the like.

And so what I would say, it certainly is, what I would say the underlying challenge within the supply chain. But I would tell you based on what I see and we track this on a weekly basis, we're making good progress and then we're working with our suppliers to do the same.

Nigel Coe
Analyst, Wolfe Research LLC

Q

That's great to hear. Thanks very much.

Operator: Our next question comes from Steve Tusa with JPMorgan. Your line is open.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC Q

Hey, guys. Good morning.

Antonella Franzen
Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc A

Good morning.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc A

Good morning, Steve.

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc A

Good morning.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC Q

Congrats Antonella and best of luck in whatever the new gig is. Thanks for all the help over the years.

Antonella Franzen
Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc A

Thank you.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC Q

What do you guys think the market is growing in kind of global applied equipment and how are you guys performing against that?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc A

Yeah. I mean when we look at our Applied business, Steve, and the work that we've done, making sure that we've got a full line-up and we've been reinvesting in new product and the like so I think we're seeing some upside from that. I think overall we've seen a nice recovery and we've capitalized on that with some of the new products. I would say the focus for us has been on low GWP refrigerant technologies, next-gen air-cooled technologies, a lot of electrification with heat pumps and heat transfer units and then in our JCH business, the VRF technology. So I think a lot of these are aligned to where we see the market going and ultimately now capitalizing on those trends around sustainability and energy efficiency. And so that's the underlying, what we see to be driving the underlying demand. When you look at our performance in Applied, both sales and orders were up low double-digits in Q1. And now a lot of this was – there's a few verticals driving this. We see strong demand in data centers and healthcare, I mean that's globally and that's driving a lot of demand for our air-cooled chillers specifically in North America.

And then the other I think what's helping this demand also is the retrofit projects that are focused on sustainability, decarbonization, healthy buildings which ultimately brings together our combined capabilities beyond just the equipment. And so I think that what's – driving it to your question of how does that play out over the rest of the year, we believe as Olivier said not only with the underlying demand and now with the strong pricing activity that we're – overall, I think it's following the demand for the overall company which is high single-digits. And we see our backlog, not only our order pipeline but then our backlog that we're developing continues to grow. And we have backlog today that now is up over 10%. So, I think it's a lot of these demand streams converging that is ultimately playing out for us as we had planned with our strategy.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And then just on OpenBlue, any tangible KPIs that you could provide to kind of give us an idea of what the trajectory of that is? I mean, I know you've talked about a few wins here and there, but anything tangible early on, I don't know, installations, accounts that you can give us to kind of track the progress there.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah. So, let me just frame up OpenBlue, because I think this is a very important fundamental. So, it's really at the center of everything we're doing. So as we talked about today, not only how we're pushing intelligence to the edge at our products and driving that now with FogHorn in our digital capabilities. But through all of this, whether it be OpenBlue Bridge, OpenBlue Twin, Active Responder, Performance Advisor, cloud, location, all of these capabilities then play out not only enhancing our ability to get more Install base, but then differentiating that base with Services.

So, we've launched these eight major offerings. We've now incorporated those into our digital services. And when you look at our digital products and Service revenue, we're up high-single digits. So, that is tracking with the investments we've made. And now, it's really now embedded in selling it as a solution. So whether it be a project where we deliver energy savings or decarbonization or indoor air quality as a solution that's embedded in the solution, and then within that solution, we get higher margin and then we get a connection that gives us the ability to now add additional digital services.

And so, the benefit for the customer is improved uptime like by 66%, higher efficiency, smart buildings impact. We can impact energy by 50%. And so, all of our solutions are based on creating these outcomes that ultimately generate a return for our customers. And we see this, over time, as we've said before, up to 10 times the value creation with how it differentiates our equipment, the solutions that we install and then the base we build to allow us to be able to deliver additional services on top of that connection. That is the framework of OpenBlue.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Great. Thanks a lot.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Thanks, Steve.

Operator: Our next question comes from Josh Pokrzywinski with Morgan Stanley. Your line is open.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Good morning all, and best of luck to Antonella. You'll be missed.

Antonella Franzen
Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc

A

Thanks.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

So, a lot of questions trying to tease out the outgrowth here from a few different angles. I guess, I want to approach it a little different as well. So, field orders up 8%, probably a few points of price in there. If I take off kind of the 2 points of outgrowth that you guys talked about at the Analyst Day, we're at kind of low-single digits which sort of feels low to call that the market since we're still comping negative and have things like stimulus helping and education. Like is that the right way to look at it? Where is the leak? And I guess, when do you expect to see more separation, I guess, on the field orders front?

Olivier Leonetti
Chief Financial Officer & Executive Vice President, Johnson Controls International Plc

A

So if you look at the field orders today, they are growing at 8%. We mentioned that. If you look at the two-year stack, the increase is steady. We believe that from a volume standpoint, the growth is really attractive. And as we deploy more of our capabilities around OpenBlue, around digital services, around indoor air quality and the like, we believe that the growth in the field would keep growing. So, so far, it's performing largely as per our expectation, Josh, and more to come.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

And Josh, just to add, when we look at these new solutions that we've launched around net zero buildings and now the Indoor Air Quality-as-a-Service, we've got a significant pipeline that we're now in the early stages of developing and beginning to convert. And that does begin to change not only the solutions and the Install base that is created with those solutions, but that gives us the Install base to ultimately get connected and then ultimately continue to build out the services.

So, I believe when you look at the full cycle, we're seeing that with the projects that are in our pipeline and how we're beginning to convert. And that's why, as Olivier said, we've been increasing our sales force because we believe that with all of the plus and minuses that we're positioning for a nice steady stream of growth here that we're positioned to be able to deliver on.

Antonella Franzen
Vice President, Chief Investor Relations & Communications Officer, Johnson Controls International Plc

A

Yeah. And the only thing I would add is we're clearly seeing the share gains, which clearly shows that we are outperforming the market. And that has been, I would say, pretty steady across the board. We gained some significant share in Applied, particularly in chillers in North America over the last 12 months. And we're also seeing gains in share in the Fire & Security portfolio as well.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Got it. That's helpful. And then just a follow-up on Nigel's question about labor. Obviously, you guys aren't the only folks at a job site, especially in kind of these big retrofits or new construction. How much of what you're doing could be held up by other folks having insufficient access to labor or kind of site delays? Like is that something that's happening now or is that something that could flare up as a risk or can you guys kind of control your own destiny if you're able to attract and retain people inside of JCI?

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

A

Yeah. So if you look at our – when we talk about labor at our facilities, at our manufacturing facilities, we've been managing around shortages and we're getting some disruption there because we had to run smaller lots through the manufacturing process and we had to do more changeovers per shift and the like. And that's why we saw some disruption there.

Why the field is greater is because when you look at North America, for instance, we have 18,000 people in the field every day on jobs. And so, it's really based on schedules and making sure that we're deploying that labor efficiently that they're going to be able to perform their work when they go on site. And so, you can imagine in this environment, with all of the changes that are happening daily, we're operating at an incredible level to maintain not only the full employment, but ultimately supporting our customers during this period of time.

And so, I think the value proposition, as we've been able to – I just looked at our January numbers as far as our hiring and we're spot-on; what we need to hire to ultimately support the growth the rest of the year. And as we work with our recruiters and the way that we're presenting ourselves in the market, there's a very attractive value proposition with the work we're doing, with ultimately the growth that we're positioned to achieve and then ultimately the problems that now we're positioned to solve for our customers. So when you put all that together, those are some of the drivers what's driving our success.

But to your point, it is – anyone that's within the supply chain today there is a level of frustration because every day, you get a curveball and you have to work around because of the shortage or the like. And to your point about our customers, we certainly are governed by the projects that we're supporting and ultimately their schedules on-site. And we're trying to work that proactively so we don't get many surprises. But you can imagine when things don't show up, then you've got to pivot and redeploy. And we've been doing that extremely well while we've been navigating through this period of time.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Great. Appreciate the detail. Best of luck.

George R. Oliver
Chairman & Chief Executive Officer, Johnson Controls International Plc

So let me wrap-up and I'll thank everyone again for joining our call this morning. As we've discussed here, we've had a very strong start to the fiscal year and the underlying momentum we are seeing in our business and the recovery within our verticals is very encouraging. And although the environment will continue to be challenging, as you've seen here our teams across the board are executing extremely well, ultimately delivering for our customers and for our shareholders.

So I'd just like to end the call and thank Antonella again for just an incredible run and for your leadership, your friendship and the impact that you've had on all of us and on the company has been phenomenal. So again thank you for that.

And I do look forward to speaking with many of you soon. There's a lot of conferences coming up and we're looking forward to further engagement.

So on that, operator, that concludes our call.

Operator: Thank you for your participation. All participants, you may disconnect at this time.